

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF P B )  
CORPORATION (FOXBORO )  
MANOR) FOR AN ADJUST- )  
MENT OF RATES PURSUANT ) CASE NO. 8682  
TO THE ALTERNATIVE )  
PROCEDURE FOR SMALL )  
UTILITIES )

O R D E R

On October 18, 1982, P B Corporation - Foxboro Manor ("Foxboro") filed an application with the Commission to increase its rate pursuant to 807 KAR 5:076, Alternative Rate Adjustment procedure for Small Utilities ("ARF"). The proposed rate would produce additional revenue of approximately \$12,603 annually, an increase of 37 percent. Based on the determination herein the revenues of Foxboro will increase by \$8,580 annually, an increase of 25 percent.

A hearing was not requested in this matter, and in accordance with the provisions of the ARF no hearing was conducted. However, an informal meeting with all parties duly notified was conducted at the request of Foxboro on February 17, 1983. The decision of the Commission is based on information contained in the application, written submissions, annual reports and other documents on file in the Commission offices.

A formal motion was made by Mr. Charles Lind, Louisville, Kentucky, a customer of Foxboro to intervene in these proceedings, which motion was granted. No other motions or documents were filed by Mr. Lind.

#### COMMENTARY

Foxboro is a privately-owned sewage treatment system serving approximately 341 customers in Jefferson County.

#### TEST PERIOD

The Commission has adopted the 12-month period ending December 31, 1981, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

#### REVENUES AND EXPENSES

The ARF was established to provide a simplified and less expensive method for small utilities to apply for rate increases with the Commission. In this case the financial data from the 1981 annual report has been used as the basis for determining the revenue requirements. Foxboro proposed no specific adjustments to the test period operating statement. The following adjustments have been made by the Commission, in accordance with its normal rate-making practices, to Foxboro's test period operating statement to reflect actual and anticipated operating conditions:

#### Operating Revenue

Foxboro's 1981 operating statement reflects total operating revenue of \$29,793 from monthly sewer charges.

However, based on the number of customers listed in the application, revenue should approximate \$34,332 annually.<sup>1</sup> This discrepancy was raised in the Commission's Order dated January 11, 1983. The response from Foxboro clearly reflects that revenues reported in the annual report were based on the net remittance to Foxboro from Louisville Water Company ("LWC"). LWC provides the billing and collection service for Foxboro and subtracts its billing fee and any other applicable charges from the revenue before remitting the net amount to Foxboro. The Commission finds that the practice of reporting the net amount received from LWC as revenue is not in compliance with the Uniform System of Accounts for Sewer Utilities as adopted by this Commission. Therefore, an adjustment of \$4,539 has been made to increase operating revenue to reflect the annual revenue based on the rates presently in effect for Foxboro and the number of customers at the end of the test period.

#### Electric Expense

In response to the Commission's Order dated November 5, 1982, Foxboro furnished copies of its monthly electric bills for the test period. In accordance with Commission practice the usage from the monthly bills was applied to the most recent rates on file for the electric utility which serves Foxboro to arrive at pro forma electric expense. No evidence has been

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<sup>1</sup>  $\$8.39 \times 341 \text{ customers} \times 12 \text{ months} = \$34,332.$

presented which would indicate that test period electric usage is abnormal. Therefore, the Commission has determined that an adjustment of \$955 should be made to increase electric expense to reflect the increase in electric rates subsequent to the test period.

#### Repairs

The response to the Commission's Order dated January 5, 1983, reflects that a "3 HP Dayton Motor" costing \$336 and a "Zoeller Pump" costing \$102 were purchased during the test period and charged to repairs. The items are replacements for existing assets. The Commission is of the opinion that the expensing of these items is not in conformity with generally accepted accounting principles. These items will benefit a period greater than 1 year and should be capitalized and depreciated over the estimated useful lives. An adjustment of \$438 has been made to reduce repairs expense and an adjustment has been made to increase depreciation expense by \$88 based on a 5-year estimated useful life.

#### Maintenance

The response to the Commission's Order dated January 5, 1983, reflects that a charge of \$346 was made to test period maintenance expense for connecting a new compressor and motor. The Commission is of the opinion that the recognition of this item as an expense is not in accordance with generally accepted accounting principles. The cost of installation should be capitalized with the cost of the asset reflected in plant in service and applicable depreciation expense recognized over the

estimated useful life. Therefore, an adjustment of \$346 has been made to decrease test period maintenance expense and depreciation expense has been increased by \$69 to reflect annual depreciation over a 5-year estimated useful life.

The response to the Commission's Order dated February 24, 1983, reflects that the monthly charge for routine maintenance service was decreased from \$850 to \$600 effective March 1, 1983, due to a change in the party providing this service. Therefore, an adjustment of \$3,000 has been made to reduce test period maintenance expense to recognize the reduction in the monthly maintenance fee.

The changes mentioned above result in total adjusted maintenance expense of \$13,200.

#### Billing Expense

As stated previously in this Order, Foxboro reports the net amount received from LWC as operating revenue. Because of this practice the billing fee charged by LWC is not being reported as an expense in Foxboro's operating statement. The Commission finds that this practice is not in conformity with the Uniform System of Accounts. These expenses should be identified and recorded on the operating statement on an accrual basis. Copies of remittance advices from LWC have been filed which reflect total billing expense of \$1,504 for the test period. Therefore, an adjustment of \$1,504 has been made to increase billing expense for the test period to recognize the omission of this item.

Item No. 3 of the response to the Commission's Order dated February 24, 1983, states that the average collection charge per bill was \$.77 in 1982 and that it was anticipated that this would increase to \$.81 per bill in 1983. The Commission typically makes adjustments to reflect increases in collection fees in sewer utility cases. Foxboro was asked to file a verifiable estimate of any increase anticipated for this expense, which it failed to do. No other evidence has been submitted which would allow the Commission to consider an increase in the expense. Therefore, the Commission has determined that no adjustment should be made in this instance.

Other Deductions - Contractual Obligations

The sewage facilities of Foxboro were originally developed in 1961 by Middletown Water District ("Middletown") pursuant to an agreement with Dorsey Development Company ("Dorsey"). The agreement required Dorsey to design and build the necessary sanitation facilities for Foxboro Manor Subdivision and Middletown to reimburse Dorsey for the cost of the facilities by collecting \$2 per customer per month from sections 1 and 2 of the subdivision. The total costs to be recovered by Dorsey were \$167,748.

In 1964 Cambron-Kendall, Inc., ("Cambron") acquired Foxboro Manor Subdivision and engaged in further development of the subdivision and also made additions to the sanitation facilities initially started by Dorsey. Some time during the mid-1960's Middletown merged with LWC and conveyed its portion

of the sewage facilities to Cambron. As part of this conveyance Cambron agreed to assume Middletown's obligation of collecting the \$2 charge from the customers in sections 1 and 2 and remitting it to Dorsey. In 1964 Dorsey, for reasons undisclosed, assigned a portion of its rights under this agreement to Mr. Clifford A. Knopf. At the present, one-third of the collections are remitted to Mr. Knopf and two-thirds to Dorsey. In 1970 Cambron was acquired by P B Corporation which is the present owner of Foxboro.

It was not until December of 1982 that Foxboro became aware of the exact circumstances of the payments to Dorsey and its assignee. As mentioned in a previous section of this Order, LWC performs the billing and collection for Foxboro. LWC sends payment directly to Dorsey and its assignee and remits the net amount to Foxboro after deducting the collection fee. Foxboro has not been directly involved in complying with the terms of the agreement. Because of Foxboro's lack of knowledge about the arrangement, there has been no disclosure in Foxboro's books. As mentioned previously, the \$2 charge only pertains to the customers in sections 1 and 2. However, all of the customers of Foxboro use the same treatment plant. Foxboro has no provision in its tariff requiring customers of sections 1 and 2 to pay an additional \$2. All of Foxboro's customers pay the same rate.

Foxboro is not obligated to pay the amount listed in the contract but serves as an intermediary in collecting the amount from the customer and remitting it to Dorsey and Mr. Knopf.

Therefore, the Commission is of the opinion that the outstanding balance due to Dorsey and Mr. Knopf should not be included as a liability on Foxboro's balance sheet because Foxboro is not primarily liable. However, a disclosure of the exact terms should be noted in the financial statements. Since all of the customers from the subdivision derive benefit from use of the treatment plant the Commission has determined that the annual remittance associated with this contractual arrangement should be included in Foxboro's operating statement as a recovery of cost. This treatment allows the establishment of a uniform rate for all the customers, which is fair and equitable in light of the unique facts of this case. Moreover, since the customers are reimbursing certain parties for a portion of the cost of the treatment plant and lines the Commission finds that these assets should be treated as contributed property and therefore, has disallowed depreciation on these assets in a subsequent section of this Order. To allow depreciation would in effect allow double recovery on those costs incurred during the initial development of this system. Copies of the remittance advices from LWC reflect that \$2,424 was paid during the test period under the terms of this contractual arrangement. Therefore, an adjustment has been made to increase test period operating expenses by this amount.



### Depreciation

Depreciation expense of \$3,813 reported in the test period operating statement is based on plant in service of \$258,436.<sup>2</sup> Item No. 14 of the response to the Commission's Order dated November 4, 1982, reflects that \$348,875 of the total sewer plant in service was recovered through the sale of lots. The contractual obligation referred to in a previous section of this Order requires \$167,748 to be paid to the original developers as reimbursement for the cost of the treatment plant and lines. This amount is to be paid through a \$2 monthly assessment on the customers of sections 1 and 2. In addition, the sewer system has changed ownership twice since its initial development in 1961. The records filed in this case have failed to provide conclusive evidence of the original cost of the sewer facilities transferred.

The evidence herein supports a conclusion that the total investment in utility plant in service at the end of the test period has been or will be recovered either through a direct contribution or through rates under the aforesaid contractual obligation. Therefore, in the absence of supporting evidence of the value of, as well as investment by Foxboro in, plant in service, the Commission finds that actual test period

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<sup>2</sup> \$372,951 - \$114,515 = \$258,436  
Total Plant - Contributions in Aid of Construction =  
Depreciable Plant.

depreciation expense of \$3,813 should be excluded for rate-making purposes. This adjustment results in total test period depreciation expense of \$157, based on previous sections in this Order concerning the capitalization of certain items charged to repairs and maintenance.

#### Taxes-Other Than Income

Foxboro has not paid property taxes of \$644 relating to the test period although it used this amount as part of its basis in determining the proposed rates. This expense was not included in the test period operating statement. The Uniform System of Accounts for Sewer Utilities as prescribed by this Commission requires the use of the accrual basis of accounting. Therefore, the Commission has made an adjustment of \$644 to increase Taxes-Other than Income for the test period.

#### Income Taxes

The Commission has made an adjustment of \$516 to increase test period income tax expense based on the net income provided as a result of the rates approved in this Order and the applicable 1983 corporate income tax rates.

#### Interest Expense

Foxboro's operating statement reflects interest expense on long-term debt of \$2,575 for the test period. The 1981 balance sheet reflects long term debt outstanding of \$18,000 at the beginning and at the end of the test period. The principal amount of the debt originated in 1977. Foxboro's portion of the total proceeds from the debt amounted to \$30,000 with \$9,137 used to pay the balance of a debt associated with the purchase

of the sewer system in 1970 and \$20,863 to pay operating expenses. This information clearly shows that approximately 70 percent of Foxboro's outstanding debt at the end of the test period is attributable to prior years' operating expenses.

The Commission has taken the position in previous cases that the management of a utility is responsible for the periodic review of utility operations to ascertain the need for an increase in revenues. Foxboro's decision to incur debt to meet operating expenses rather than seek an increase in revenues results in an undue burden on the present ratepayers in the form of interest expense. Therefore, the Commission has determined that interest expense for the test period should be reduced by \$1,751 to eliminate the interest expense on funds borrowed to cover operating expenses.

After consideration of the aforementioned adjustments, the Commission finds Foxboro's adjusted test period operations to be as follows:

	<u>Actual Test Period</u>	<u>Pro forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$29,793	\$4,539	\$34,332
Operating Expenses	38,441	(1,397)	37,044
Operating Income	<u>\$(8,648)</u>	<u>\$5,936</u>	<u>\$(2,712)</u>
Interest Expense	2,575	(1,751)	824
Net Income	<u>\$(11,223)</u>	<u>\$7,687</u>	<u>\$(3,536)</u>

#### REVENUE REQUIREMENTS

Foxboro's proposed increase in revenue was based on certain test period operating expenses which were unpaid as of the date of the application and an operating loss for the test

period. The Commission is of the opinion that the operating ratio<sup>3</sup> is a fair, just and reasonable method for determining revenue requirements in this case. The Commission finds that an operating ratio of 88 percent will allow Foxboro to pay its operating expenses, service its debt and provide a reasonable return to its owners. Therefore, the Commission finds that Foxboro is entitled to increase its rate to produce total revenue of \$42,912 which will require an increase of \$8,580 annually.

The Commission has made adjustments to reflect a normal level of revenue and expense for rate-making purposes. Some of the adjustments were necessary because Foxboro's records did not conform to generally accepted accounting principles or because of failure to follow accounting practices prescribed by the Uniform System of Accounts for Sewer Utilities as adopted by this Commission. To take advantage of the ARF, a utility must maintain adequate financial records and submit accurate annual reports. Therefore, in the future Foxboro should maintain accurate and complete records in order to comply with the regulations established by this Commission.

#### SUMMARY

The Commission, after consideration of the evidence of record, finds that:

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<sup>3</sup> Operating Ratio =  $\frac{\text{Operating Expenses} + \text{Taxes}}{\text{Gross Revenue}}$

(1) The rate in Appendix A will produce gross annual operating revenue of \$42,912 and is the fair, just and reasonable rate to be charged in that it will allow Foxboro to pay its operating expenses and provide a reasonable surplus for equity growth.

(2) The rate proposed by Foxboro should be denied.

(3) Foxboro has failed to conform to the Uniform System of Accounts for Sewer Utilities as specified herein and adjustments should be made to bring its accounting records into compliance.

IT IS THEREFORE ORDERED that the proposed rate in Foxboro's application be and it hereby is denied.

IT IS FURTHER ORDERED that the rate in Appendix A be and it hereby is approved for sewer service rendered by Foxboro on and after the date of this Order.

IT IS FURTHER ORDERED that Foxboro shall make the necessary adjustments to its records in the areas specified herein in order to be in compliance with Commission regulations.

IT IS FURTHER ORDERED that within 30 days of the date of this Order Foxboro shall file its revised tariff sheets setting out the rate approved herein.

Done at Frankfort, Kentucky, this 25th day of April, 1983.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 8682 DATED April 25, 1983.

The following rate is prescribed for all customers  
served by PB Corporation-Foxboro Manor. All other rates and  
charges not specifically mentioned herein shall remain the same  
as those in effect prior to the date of this Order.

Residential Users

\$10.50 per Month